FILED
81 2 1980
CLERK

No. 79-1907

In the Supreme Court of the United States

OCTOBER TERM, 1979

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

PORTLAND CEMENT COMPANY OF UTAH,
Respondent

On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Tenth Circuit

BRIEF FOR PORTLAND CEMENT COMPANY OF UTAH IN OPPOSITION

JOHN J. MARTIN
Attorney for Respondent
One Greenwich Plaza
Greenwich, Conn. 06830

GLEN E. FULLER
Attorney for Respondent
678 East South Temple
Salt Lake City, Utah 84102

INDEX
CITATIONS

Cases:

Page

Arvonia-Buckingham Slate Co. v. United States, 426 F. 2d 484 10

General Portland Cement Co. v. United States, 438 F. Supp. 27 10

Golsen v. Commissioner, 57 T. C. 742, aff'd. 445 F. 2d 985, cert. denied, 404 U.S. 940 4

Mississippi Valley Portland Cement Co. v. United States, 347 F. Supp. 240 11

Portland Cement Co. of Utah v. Commissioner of Internal Revenue (1980), 614 F. 2d 724 3

Portland Cement Co. of Utah v. United States, (1969), 412 F. 2d 894 9

Southwestern Portland Cement Co. v. United States, 435 F. 2d 504 10

United States v. California Portland Cement Co., 413 F. 2d 161 10

United States v. Ideal Basic Industries, Inc., 404 F 2d 122, cert. denied, 395 U. S. 936, rehearing denied, 396 U. S. 975 2

United States v. Portland Cement Co. of Utah, 378 F. 2d 91, cert denied 389 U. S. 975 11

In the Supreme Court of the United States

No. 79-1907

OCTOBER TERM, 1979

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

PORTLAND CEMENT COMPANY OF UTAH,
Respondent

On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Tenth Circuit

BRIEF FOR PORTLAND CEMENT COMPANY OF UTAH IN OPPOSITION

The questions presented by petitioner are concerned with details of the application for income tax depletion purposes of the so-called "proportionate profits" method of determining gross income from mining to respondent, an integrated miner-manufacturer of cement. Respondent opposes the issuance of a writ of certiorari for the reasons hereinafter set forth.

ARGUMENT

I.

THE QUESTIONS PRESENTED BY PETITIONER CONSTITUTE A SUBSTANTIAL DEPARTURE FROM THE PRIMARY ISSUE WHICH WAS DECIDED IN THE COURTS BELOW; AND, ON THE ISSUES ACTUALLY PRESENTED, THE COURTS BELOW CORRECTLY APPLIED BOTH DECISIONAL LAW AND APPLICABLE TREASURY REGULATIONS

The petitioner in this matter expresses disapproval with the case of *United States v. Ideal Basic Industries, Inc.*, 404 F.2d 122, cert. denied, 395 U.S. 936, rehearing denied, 396 U.S. 975, wherein it was held by the Tenth Circuit that for income tax depletion purposes of cement producers the "first marketable product" under Treasury Regulations is bulk cement. As such, a frontal attack is being attempted by petitioner for a second time in an attempt to have this Court issue a writ of certiorari some eleven years later, claiming that "developments" have occurred in the interim period.

It is interesting to note, however, that the matter was pursued by petitioner in both lower courts on the basic premise that certain changes in the Treasury Regulations in 1972 had brought about a change in the definition of "first marketable product", thereby circumventing the ruling of *Ideal Basic* by the oblique approach of leaving that decision suspended without any

underlying support. In substance, petitioner took the position that the power granted by Congress to issue Regulations was controlling on the Courts, and that, in fact, Treasury Regulations were changed so as to circumvent *Ideal Basic*.

The changed Regulations considered by the Tenth Circuit and the Tax Court below were also brought to the attention of this Court in *Ideal Basic* when certiorari was sought in 1969, wherein it was belatedly argued that the new Regulations should justify a change in the *Ideal Basic* decision; further, it was also brought out at that time that there was a conflict in certain particulars of the Tenth Circuit decision in *Ideal Basic* with those of cases in both the Fourth Circuit and the Ninth Circuit. There has been no significant change since then.

Both the Tax Court and the Tenth Circuit were primarily concerned with whether Treasury Regulations had in fact altered the definition of "first marketable product", and both courts held that no such change had been made. The Tenth Circuit observed in its recent opinion found in 614 F. 2d 724, as follows:

> "The Tax Court held that the changes in the Treasury Regulations in 1972 (Sec. 1.613-4 (d) (4)) would not bring about a change in the result reached in *Ideal Basic*. It determined that the basic consideration was that of the 'first marketable product.' It noted that the 1972 Regulations carried over the same provisions as were relied on in *Ideal Basic Industries* in the 1968 Regulations. We can add little if anything to

> the analysis made by the Tax Court, and we agree with the conclusion reached."

As pointed out in the Tax Court opinion at 36 T.C.M. 578, petitioner there argued that the rule of *Golsen v. Commissioner*, 57 T. C. 742, aff'd 445 F. 2d 985, cert. denied, 404 U. S. 940, would not bind the Tax Court to the decision in *Ideal Basic* inasmuch as pertinent Regulations adopted subsequent to the Tenth Circuit's decision in *Ideal Basic* had worked a change in the legal atmosphere so as to make the *Golsen* rule inapplicable.

In holding that the new Regulations had not accomplished the result claimed by the Commissioner, the Tax Court refused to accept the government's position and concluded that *Golsen* should apply:

> "Respondent's view, however, overlooks a pivotal consideration. Nothwithstanding the new regulation's specific mention of bags and bagging costs, such additional language does not purport to alter the definition of the makeup of the elements which constitute the first marketable product.[6] Rather, such change merely clarifies the classification among certain costs which are common to almost all integrated mining-manufacturing operations."[7]

---

[6] Sec. 1.613-4 (d) 4 (iv), which defines the term "first marketable product," was transferred completely intact from the old to the new regulatory material.

[7] Indeed, the Tenth Circuit takes no issue with the view that the cost of bags and bagging constitutes non-mining expenses. See **Ideal Basic Industries**, supra, at 125.

The Tenth Circuit seems to have little quarrel that costs of bags and bagging cement, bulk loading, ad-

vertising and selling are non-mining costs under the so-called "proportionate profits" formula utilized in the cement and other extractive mineral industries, but it does take a definite position that bulk cement, rather than both bulk and bagged cement, constitutes the "first marketable product" under the Regulations and that non-mining costs beyond the bulk cement stage should be excluded entirely from the "proportionate profits" formula. If, as petitioner before this Court has contended in the courts below, it can define "first marketable product" by Regulations which are binding on all courts, then it would seem that petitioner should proceed to adopt new Regulations accomplishing its desired purpose rather than petition this Court to overrule existing case law or, indeed, its own Regulations.

II.

THE POINT AT WHICH CEMENT BECOMES THE "FIRST MARKETABLE PRODUCT" UNDER TREASURY REGULATIONS INVOLVES ONLY ONE RELATIVELY MINOR ISSUE AMONG MANY PROBLEMS CREATED BY THE "PROPORTIONATE PROFITS" METHOD OF ARRIVING AT CONSTRUCTIVE INCOME FROM MINING.

Inherent in any discussion of income tax depletion allowances in the cement industry, and many other extractive industries, is a consideration of the "proportionate profits" formula for determining a constructive gross sales figure at the point where mining terminates in

those instances where actual sales of the product do not occur because of an integrated manufacturing process. In the case of cement, Section 613 (c) (4) (F) of the Code provides that mining ceases at the point where the raw mineral product is finely ground, mixed with water to form a slurry, and fed into rotating kilns for burning. All mining costs prior to the kiln-feed point are totaled and the percentage that those costs bear to the total cost of producing the "first marketable product" forms the basis from which can be determined the gross income from mining.

Petitioner asserts (Br. 13) that the basic theory of the "proportionate profits" methods is that ". . . every dollar of the producer's costs, mining and non-mining alike, is deemed to produce the same proportionate part of the profits earned through sales of the first marketable product; . . ." Further, it is contended by petitioner that the premise that every dollar of costs produces the same rateable part of the profits is in accord with long-settled principles of corporate accounting.

It is certainly true, as accountants universally recognize, that every dollar of costs must be taken into account in arriving at profits, but to suggest that every dollar of costs produces the same proportionate part of the profits is the most inaccurate and absurd statement imaginable, more likely to be accepted by participants in bankruptcy court than in the arena of competitive business activities. It requires little imagination to perceive that profits are the result of an excess of receipts over costs, and that any business which can reduce its

costs in relation to its receipts will show the greater relative percentage of profits.

The "proportionate profits" formula is a misnomer; it is a proportionate *costs* formula — and nothing more. It does not realistically provide a depletion allowance commensurate with a return of the miner's capital interest in depletable materials.

Thus, in applying the "proportionate profits" formula, a cement producer having a deposit of raw materials which is of relatively poor quality, or which is very difficult to quarry, or who exercises poor management or allows its machinery to be poorly maintained or damaged, would likely find that the proportion of the costs expended in the production of its first marketable cement product would lean very heavily to the "mining" side of the "proportionate profits" formula. On the other hand, a cement producer operating efficiently and with a choice deposit of raw materials would find that the percentage attributable to its "mining" operations would usually be smaller than that of its less efficient competitor with a poorer deposit. As such, the application of the "proportionate profits" formula actually operates as a subsidy to the inefficient, high cost producer by furnishing it with a higher "mining" percentage — and a greater amount of depletion, and places the efficient producer with a quality deposit at a competitive disadvantage.

The foregoing brief illustration of how the "proportionate profits" formula operates has been advanced at this point primarily to bring into proper focus peti-

tioner's representation (Br. 10) that there are "currently 24 proportionate profits cases presently pending either in the courts or administratively with approximately $26 million at stake."

Because of the inherent fallacy of the "proportionate profits" formula, it is entirely possible that the representation is accurate if we consider pending cases involving *all aspects* of the "proportionate profits" formula. But respondent challenges the implication and submits that the nature of the narrow issue here presented involves only a small fraction of the quoted amount, and further suggests that petitioner's representation is a calculated misrepresentation.

The number of cases presently pending involving the determination of "first marketable product" in the cement industry, and the application of non-mining costs beyond that point in applying the formula, should certainly be relatively few in number and a small portion of the total monetary amount at issue since the various aspects of the "proportionate profits" formula which can give rise to litigation are undoubtedly very numerous. Although respondent does not have access to the information, petitioner's generalized statement of pending "proportionate profits cases" is of no help in assessing the monetary impact of the narrow "first marketable product" issue in the cement industry.

To illustrate the relative small difference in the corporate income taxes payable by utilizing the "first marketable product" concept of *Ideal Basic* and com-

paring the corporate income taxes payable on the same group of costs by applying petitioner's version of the "proportionate profits" formula, we find a good illustration in this particular case. Subject to possible incidental adjustments, a computation of respondent's corporate income tax reduction under *Ideal Basic* would result in a lowered tax liability for the three fiscal years involved, in the following amounts:

Fiscal year ended March 31, 1970	$10,045.98
Fiscal year ended March 31, 1971	$ 8,138.91
Fiscal year ended March 31, 1972	$ 5,299.29
Total	$23,484.18[1]

When one considers that respondent paid federal corporate income taxes for the three fiscal years from its cement-producing operations in an amount exceeding $1,500,000, the relative importance of the narrow and technical issue raised by petitioner dwarfs what appears to be a vendetta against respondent by petitioner. It should be noted that these litigants have been before the Tenth Circuit on six different occasions involving the proper method of computing respondent's depletion allowance. On the fifth appeal, in *Portland Cement Co. of Utah v. United States* (1969), 412 F.2d 894, the case was remanded to have respondent's depletion allowance computed under *Ideal Basic* — and petitioner did not seek certiorari. Having failed in its attempt to

[1] The greater amount of deficiency shown in the Tax Court decision (Petitioner's Brief 1a) was mostly due to the fact that in the first two years respondent computed its depletion allowance on a method other than the "proportionate profits" formula.

convince the Tax Court and the Tenth Circuit that its Treasury Regulations did in fact over-ride *Ideal Basic* and the fifth *Portland Cement Co. of Utah* decision, petitioner is now falling back on the approach it should have undertaken against respondent back in 1969.

A review of some of the cases cited by petitioner involving the "proportionate profits" formula reveals the existence of several issues in nearly every case. As an example, in *General Portland Cement Co. v. United States*, 438 F. Supp. 27 (appeal pending to the Fifth Circuit) the issue of first marketable product of that cement producer was resolved to include both bagged and bulk cement where the facts established that up to 20%[2] of its cement sales were made in bags; but on a separate issue—one of several, the court held that cash discounts should not be deducted from gross sales.

Petitioner's other cases which deal with cash discounts in the cement industry are *Southwestern Portland Cement Co. v. United States*, 435 F. 2d 504, and *United States v. California Portland Cement Co.*, 413 F. 2d 161—both of which held such discounts to be "trade" discounts, and deductible from gross sales.

To compound the areas of confusion under the "proportionate profits" formula, the handling of selling and marketing expenses has given the courts no end of trouble. In *Arvonia-Buckingham Slate Co. v. United*

---

[2] Respondents bagged cement sales, by contrast, were testified at the trial to be:

Fiscal year ended 3/31/70	7.0%
Fiscal year ended 3/31/71	8.0%
Fiscal year ended 3/31/72	6.5%

States, 426 F. 2d, 484, *California Portland* and *Southwestern Portland*, the courts held that selling expenses should be allocated between mining and non-mining costs in the formula. On the other hand, a contrary result was reached in *Mississippi Valley Portland Cement Co. v. United States*, 347 F. Supp. 240. The courts have recognized the inherent difficulties in allocating selling and marketing costs between mining and non-mining segments of the formula.

Petitioner should really have little concern with the relatively insignificant issue of when a cement producer creates its "first marketable product" under the "proportionate profits" formula; rather, petitioner should be more concerned with arriving at a better degree of justice among miners by submitting to this Court the issue of the validity of the "proportionate profits" formula itself. In 1967, after the Tenth Circuit decided that this respondent should compute its depletion allowance under the "proportionate profits" formula in *United States v. Portland Cement Co. of Utah*, 378 F. 2d 91, this respondent attempted to secure a writ of certiorari from this Court (October Term, 1967 — No. 640). In so doing, respondent there sought to test the validity of the "proportionate profits" formula. However, certiorari was denied, 389 U. S. 975.

Since the "proportionate profits" formula is arbitrary and reaches a result which often goes in a direction clearly opposite to the intent of the law in providing a depletion allowance for the exhaustion of the value of the mineral deposit, it is understandable that

petitioner will be subjected to litigation from many different sources involving its application.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

John J. Martin
One Greenwich Plaza
Greenwich, Conn. 06830
Attorney for Respondent

Glen E. Fuller
678 East South Temple
Salt Lake City, Utah 84102
Attorney for Respondent